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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.**

In the Matter of)	
)	
Price Cap Performance Review)	CC Docket No. 94-1
for Local Exchange Carriers;)	
Treatment of Video Dialtone Service)	
Under Price Cap Regulation)	

**REPLY COMMENTS OF
THE CALIFORNIA CABLE TELEVISION ASSOCIATION
IN THE THIRD FURTHER NOTICE OF PROPOSED RULEMAKING**

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INTRODUCTION AND SUMMARY

In their initial comments, the local exchange carriers ("LECs") uniformly supported the establishment of a de minimis threshold below which video dialtone costs and revenues will not be segregated from those for telephone service for purposes of the sharing and low-end adjustment mechanisms. While many of the LECs recommended adoption of a de minimis threshold mechanism that was different than the rate of return-based test proposed by the Commission, each claimed that its proposal was fashioned to reduce administrative reporting burdens and the potential adverse impact of video dialtone implementation on rates for other interstate services.

CCTA again asserts that the proposals to establish a de minimis threshold should be rejected. No commenter has demonstrated convincingly that there is any utility in making the separate video dialtone basket more complex by imposing the Commission's proposed de minimis threshold requirement.^{1/} To the contrary, the establishment of a de minimis threshold mechanism will increase the administrative burdens of implementing and

^{1/} See In the Matter of Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation, Second Report and Order and Third Further Notice of Proposed Rulemaking, CC Docket No. 94-1, FCC 95-394 (rel. Sept. 21, 1995) ("Second Report and Order" or "Third Further Notice"), CCTA Comments at 6-7 (filed Oct. 27, 1995).

monitoring video dialtone investment while offering price-cap LECs additional opportunities to subsidize their entrance into the video dialtone marketplace with telephony ratepayer funds. Given the strong incentives to misallocate the costs of video dialtone to telephony services,^{2/} the Commission should require price-cap LECs immediately to segregate video dialtone costs from telephony costs.

Should the Commission find it necessary to adopt some de minimis threshold, however, it should impose a true de minimis threshold level in the form of an absolute dollar value -- based upon both wholly dedicated and shared video dialtone costs -- in keeping with the Commission's goal of minimizing the risk of cross-subsidization. CCTA believes this threshold should be set at a maximum absolute \$3 million value of both dedicated and common video dialtone costs so that any video dialtone costs above this level would be segregated. In this way, the Commission could foster its goal of excluding instances that could be deemed not to have a significant effect on the LEC's overall interstate earnings. At the same time, a fixed threshold creates fewer administrative burdens and is easily tracked by all interested parties.

Finally, CCTA continues to reiterate that the Commission must address the critical issues of cost allocation before developing further accounting procedures. Until the Commission determines through the examination of detailed cost studies that video dialtone

^{2/} In the Matter of Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 244, 344 (1994) ("Video Dialtone Reconsideration Order"), appeal pending sub nom., Mankato Citizens Telephone Company v. FCC, No. 92-1404 (D.C. Cir. filed Sept. 9, 1992).

rates relate to the costs of providing such service, LECs will continue to have the incentive and ability to offer video dialtone service at predatorily low rates.

I. THE COMMISSION SHOULD NOT ESTABLISH A DE MINIMIS THRESHOLD

In proposing to erect a procedural mechanism which enables price cap LECs to postpone the segregation of video dialtone costs and revenues until the LECs reduce their overall rate of return by 10 or 25 basis points,^{3/} the Commission has created an artificial construct which is unnecessary and counterproductive. As many commenters stated, a de minimis threshold is unnecessary to reduce reporting burdens because the Commission has already required LECs to report all video dialtone investment in a manner that is separate and distinct from telephony service costs.^{4/} There is therefore little genuine administrative benefit in requiring price cap LECs first to commingle, and then extract, video dialtone cost and revenue information, as these LECs are required to separate these costs for reporting purposes in any event.

In addition to being unnecessary, the de minimis threshold proposal also creates substantial public interest risks. As CCTA noted, such a structure enables price cap LECs to commingle video dialtone costs and revenues with costs and revenues from other services, creating the potential for anticompetitive manipulation.^{5/} Moreover, these gaming

^{3/} Third Further Notice at ¶ 40.

^{4/} See, e.g., NCTA Comments at 7; Cox Petition for Reconsideration, CC Docket No. 94-1, at 6-7 (filed Nov. 6, 1995). Significantly, these reporting requirements contain no de minimis threshold exemptions.

^{5/} See CCTA Comments at 4-5; 8-11.

opportunities are significant as they provide LECs with the opportunity to commingle large amounts of video dialtone investment with telephony service costs.^{6/}

Further, while some commenters attempt to dismiss such cross-subsidization concerns on the grounds that "the level of VDT investment is not expected to be significant until VDT networks are fully constructed,"^{7/} this is clearly incorrect. As a general rule, LECs seeking authorization to operate video dialtone facilities have estimated that construction of their wireline networks will continue unabated for 7-15 years.^{8/} Indeed, Pacific Bell ("Pacific"), Bell Atlantic and The Southern New England Telephone Company ("SNET") have already spent considerable amounts to plan and construct only small portions of their video dialtone wireline networks.^{9/} Clearly, the assertion that the potential for LEC cross-subsidization will not occur until the video dialtone networks are fully constructed should be dismissed as baseless.

^{6/} For example, NCTA estimated that Bell Atlantic's total plant in service could grow by \$138 million dollars before its rate of return for interstate regulated services would fall from 11.25% to 11.00%. See NCTA Comments at 8.

^{7/} See GTE Comments at 5.

^{8/} See, e.g., In the Matter of the Application of Pacific Bell, File No. W-P-C 6913, Application, File at 10 (Dec. 20, 1993)("Pacific Bell will invest \$16 billion over the next 7 years"); In the Matter of the Application of SNET, File No. W-P-C 7074, Application at i (Apr. 28, 1995).

^{9/} See, e.g., In fact, SNET has already invested approximately millions of dollars to construct slightly more than ten percent of the plant assets attributable to its video dialtone network in Connecticut. See Application of SNET for Financial Review and Proposed Framework for Alternative Regulation, Docket No. 95-03-01, Hearing Transcript at 77 (Serrano). Given the substantial investment required to conduct video dialtone trials, BellSouth's and SBC's request that costs related to video dialtone trials be excluded from any segregation requirements should be rejected. See Bell South Comments at 2; SBC Comments at 9.

Significantly, the amount of dedicated video dialtone investment identified by most LECs is only a small fraction of their multi-billion dollar rate bases.^{10/} Moreover, most LECs are deploying hybrid broadband networks and proposing to identify only a small fraction of total network costs as dedicated video dialtone investment.^{11/} Consequently, the de minimis threshold proposal could permit price cap LECs to concentrate significant investment in the video dialtone marketplace before the segregation requirement is triggered. Thus, Pacific's net plant in service could grow by over \$55 million before triggering the de

^{10/} For example, Pacific's alleged \$88 million in dedicated video dialtone investment, see CCTA Comments at 8, n.17, is but 3.67% of Pacific's \$2.4 billion net interstate plant in service. See Monitoring Report, CC Docket 87-339 at 450 (rel. May 1995). Given Pacific's plans to introduce both intrastate and interstate services, see Pacific Comments at 5, the percentage of Pacific's reported interstate video dialtone investment as compared to its rate base will be considerably lower than 3.67%.

^{11/} For example, Pacific represented that its dedicated video dialtone investment of (\$68 per home passed) represents approximately 33 percent of its purported video dialtone investment, see NCTA Comments, File Nos. W-P-C 6913-6916, at 7 (filed April 10, 1995); see Pacific Ex Parte Presentation, File Nos. W-P-C 6913-6916, Exhibit III, Exhibit 1, at 4 (filed March 21, 1995) and 8.5% of the alleged cost of deploying its HFC network for both video and telephony services. See CCTA Comments at 9, n.19.

CCTA reiterates its view that Pacific has understated its true video dialtone costs by misassigning components of its HFC network that should have been assigned to dedicated video dialtone accounts to either common or telephony accounts. Misassignment of components of the HFC network by Pacific has led to a gross misallocation of costs away from video dialtone and onto telephony ratepayers. Thus, Pacific claims that 22 percent of total investment is video dialtone in nature when a reasoned analysis of Pacific's network consistent with the Commission's cost allocation precedents leads to the conclusion that more than 50 percent of the network's cost should be assigned to video. See In the Matter of the Application of Pacific Bell, File Nos. W-P-C 6913-6916, CCTA Reply to Pacific Bell's Opposition to Petitions to Deny at 16-22 and Exhibit No. 3, Affidavit of Dr. Robert A. Mercer (filed Mar. 11, 1994); see also Ex Parte letters from CCTA to Kathleen M.H. Wallman, File Nos. W-P-C 6913-6916 dated January 6, January 20, and April 11, 1995; CCTA Opposition to Pacific Bell's Petition for Expedited Waiver of Part 69 Rules, File No. CCB Pol 95-10, at 2-5, 8-12 and Exhibits A-E (filed Oct. 2, 1995).

de minimis threshold at 25 basis points. At 10 basis points the corresponding threshold would be approximately \$22 million. Under the Commission's proposal, this \$22-55 million threshold level would be measured against the amount of interstate "dedicated video dialtone investment."^{12/} Given that Pacific represents its dedicated video dialtone investment to be approximately 33 percent of its total video dialtone investment,^{13/} the Commission's "low-end" de minimis threshold proposal of 10 basis points would allow Pacific to postpone the separation of video dialtone costs and revenues until the Company expended almost \$67 million. Under the 25 basis point proposal, Pacific's de minimis threshold would not be triggered until the Company invested approximately \$167 million in its video dialtone network.

The alternative proposals offered by the LECs in their opening comments reaffirm CCTA's belief that the Commission should reject the establishment of any de minimis threshold. Not surprisingly, the LECs proposed various de minimis schemes designed to maximize opportunities to engage in cross-subsidization, including multiple rate of return based proposals,^{14/} percentage of investment tests,^{15/} and percentage of revenue

^{12/} Third Further Notice at ¶ 40.

^{13/} See supra n.11.

^{14/} See GTE Comments at 5-6; Bell Atlantic Comments at 4-5; NYNEX Comments at 3.

^{15/} See Pacific Comments at 2 (de minimis threshold should not be triggered if interstate dedicated video dialtone plant in service is less than 1% of the LEC's total interstate investment); SNET Comments at 5 (threshold should be set at a ratio of 5 percent of direct video dialtone assets deployed as compared to interstate telephone plant in service); GTE Comments at 6 (set threshold at 10% of a company's investment that is wholly dedicated to video dialtone).

thresholds.^{16/} While all mechanically different, all of these proposals would allow price cap LECs to construct a significant portion of their wireline video dialtone platform before triggering a de minimis threshold and appear guided by the clear desire of the LECs to tilt the regulatory playing field in their favor.^{17/}

II. IF THE COMMISSION DOES UTILIZE A DE MINIMIS THRESHOLD, IT SHOULD SET AN ABSOLUTE DOLLAR AMOUNT THAT INCLUDES BOTH WHOLLY DEDICATED AND SHARED VIDEO DIALTONE INVESTMENTS

Should the Commission decide to adopt a de minimis threshold test despite the lack of benefits to such an approach, it should establish an administratively simple threshold that permits small and mid-size LECs to conduct technical tests of video dialtone services while reducing the ability and incentives for price cap LECs to leverage their market power in telecommunications to cross-subsidize video dialtone investment.

As such, the establishment of a de minimis threshold set using an absolute \$3 million value, which includes both wholly dedicated and shared video dialtone investments, would provide the Commission with a better alternative than a basis point proposal.^{18/}

^{16/} See US West Comments at 2 (recommends a threshold level triggered when interstate video dialtone revenues exceed 2 percent of their overall interstate revenues).

^{17/} For example, these LEC proposals could allow Pacific to invest anywhere from \$17 to \$543 million in interstate dedicated video dialtone services before the Company would be required to segregate these costs into the separate video dialtone basket. An analysis of the video dialtone investment threshold levels that would be established for Pacific under various LEC proposals is attached hereto as Exhibit 1.

^{18/} As stated in CCTA's opening comments, if the Commission insists upon establishing a rate of return based de minimis threshold, it must be triggered by a significantly smaller basis point reduction than was proposed in the Third Further Notice to ensure that it is truly de minimis. CCTA Comments at 23. Moreover, because the rate of return calculation is too susceptible to manipulation and regulatory gaming, CCTA recommends that any rate of return-based de minimis threshold adopted by the Commission should be subject to a \$3
(continued...)

Establishment of an absolute dollar threshold reduces the LECs' ability to employ the de minimis threshold to cross-subsidize for any substantial length of time. At the same time, the establishment of a \$3 million ceiling would enable price cap LECs to conduct reasonably sized technical and marketing trials without triggering the de minimis threshold level.^{19/}

Finally, an absolute dollar threshold level can be easily understood by all interested parties and would eliminate the need for the Commission to entertain proceedings to resolve unnecessary threshold disputes that would arise under the de minimis proposals recommended by the LECs.

III. THE COMMISSION MUST ADDRESS CRITICAL COST ALLOCATION ISSUES IN ACCORDANCE WITH COST CAUSATION PRINCIPLES

The Commission also invited parties to comment on "the method or factor to be used in Part 69 for allocating video dialtone costs to the video dialtone basket."^{20/} As CCTA, NCTA and others noted in their initial comments, however,^{21/} the accounting construct that

^{18/}(...continued)

million ceiling, which includes both dedicated and shared video dialtone investment. Thus, AT&T's recommendation to adopt a de minimis threshold set at the amount of dedicated and shared video dialtone investment that would reduce the LEC overall rate of return by no more than five basis points, or \$100,000, whichever is greater, see AT&T Comments at 3-7, might be reasonable if also subject to a de minimis ceiling of \$3 million.

^{19/} For example, the establishment of a de minimis ceiling at \$3 million would enable the Puerto Rico Telephone Company to conduct its proposed one-year technical trial of 250 homes, 18 public schools and 12 business offices without requiring the establishment of a separate video dialtone basket. See Puerto Rico Telephone Company, File No. W-P-C 6949, DA 94-1384 at ¶ 24 (rel. Dec. 1, 1994). Likewise, SNET's initial application to conduct a one-year technical and market trial of 1,500 homes in West Hartford would have also fallen under this \$3 million de minimis ceiling. See SNET, 9 FCC Rcd 1019, 1020 (1993) ("SNET estimates the total trial costs to be \$2,740,000.").

^{20/} Third Further Notice at ¶ 41.

^{21/} See, e.g., CCTA Comments at 14-17; NCTA Comments at 3-4.

should govern the allocation of video dialtone costs cannot be decided properly until the Commission first decides "which costs are truly the consequences of a carrier's decision to provide video dialtone service."^{22/} As NCTA pointed out, the Commission's reluctance to address the seminal issue of cost allocation may result in regulation by default,^{23/} thus allowing the LECs to decide this critical public policy issue. To avoid this result, CCTA reiterates that if the Commission is to promote the bedrock objectives of video dialtone, it must commit now to a fundamental and thorough examination of video dialtone costs and reach the critical determination that all costs incurred due to a decision to deploy a particular service should be assigned to that service.

Pacific's proposed process for allocating video dialtone costs to the video dialtone basket illustrates the dangers that may be realized by the Commission's unwillingness to address cost allocation methodology. Pacific advocates a "simple" three-step approach which: (1) calculates a total video dialtone amount made up of both shared and dedicated video dialtone investment; (2) determines the interstate and intrastate portion of the total

^{22/} Id., In the Matter of Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 244, 345, ("Video Dialtone Reconsideration Order"), appeal pending sub nom., Mankato Citizens Telephone Company, No. 92-1404 (D.C. Cir. filed Sept. 9, 1992). Recognizing these concerns, Commissioner Barrett urged the FCC to resolve in the near term the "very important and yet unanswered cost allocation issues" associated with video dialtone service. See Pacific Bell Order, Concurring Statement of Commissioner Andrew C. Barrett. Commissioner Barrett stated that the FCC's practice of waiting until the tariff review process to make such decisions has, in at least one case, allowed rates to remain in effect, "which have the potential of being predatorily low." Id.

^{23/} See NCTA Comments at 3-4.

video dialtone costs^{24/} identified in step (1); and (3) assigns the amount of video dialtone interstate investment to the video dialtone basket.^{25/} While undeniably "simple," this three-step process does nothing to "promote the Commission's goal of avoiding cross-subsidies between VDT and telephony."^{26/}

Rather than being directed and guided by effective FCC accounting and allocation "safeguards," Pacific implies that such safeguards are unnecessary because the Company can be trusted to do the right thing.^{27/} Pacific's history of using its bottleneck to engage in anticompetitive behavior -- with or without FCC safeguards -- suggests otherwise.^{28/}

^{24/} Pacific asserts that it intends to offer two services, analog broadcast service and digital broadcast service, on an interstate basis and one undefined future service, titled "Digital Interactive Service," at the state level. See Pacific Comments at 5.

^{25/} Pacific Comments at 3-6.

^{26/} See Pacific Comments at 6.

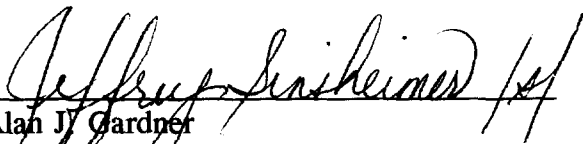
^{27/} In effect, Pacific asks the Commission to trust it to make the proper allocation determinations, stating: "We will not combine the VDT investment with telephony investment prior to the Part 69 allocation. Rather, we will distinguish between the VDT investment and our telephony investment at the first step of the process, and directly assign the VDT interstate investment to its own VDT basket." See Pacific Comments at 6.

^{28/} For example, the California Public Utilities Commission ("CPUC") recently warned Pacific to cease moving television cables into areas violating agency clearance rules in order to make room for its HFC network, see, e.g., Letter from Harry Strahl, Acting Chief, Utilities Safety Branch, CPUC, to Mary Vanderpan, Regulatory Vice President, Pacific Bell, File No. G.O. 95/3069, dated July 10, 1995, and, in a separate proceeding, issued a preliminary injunction against Pacific, concluding that Pacific was in violation of its own intrastate tariffs for refusing to route the tolls calls of certain customers to competing carriers. MCI Telecommunications Corp. v. Pacific Bell, No. 95-05-020, 1995 Cal. PUC LEXIS 458 (May 10, 1995).

CONCLUSION

For the reasons set forth herein, the Commission should decline to adopt a de minimis threshold, or, in the alternative, adopt a fixed threshold of \$3 million, and determine the proper allocation of video dialtone costs based upon basic principles of cost causation.

Respectfully submitted,



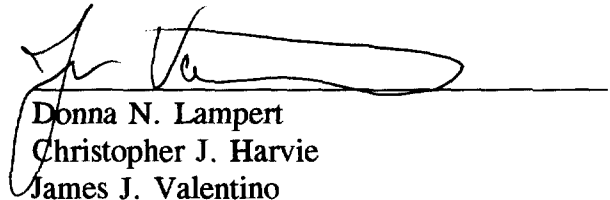
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EXHIBIT 1

VDT Investment Threshold Levels - - Alternative Trigger Mechanisms

{All Figures for Pacific Telesis, CA Only, 1994, Interstate; Dollar Figures in Millions }

Threshold VDT
Investment Level:
Trigger Amount

Special Conditions/Caveats

Alternative Based on:

Company Overall Investment -

VDT Invest. Reaches a Trigger % of Total Co. Invest.
(Set VDT/Co. Investment Ratio at __ percent)

			Percentage	
[Pac Tel]	[1]	a.	1	\$24.242
[Pac Tel]		b.	1	\$54.336
[NET]	[2]	a.	5	\$121.212
[NET]		b.	5	\$271.681
[GTE]	[3]	a.	10	\$242.423
[GTE]		b.	10	\$543.363

Company Investment is Net of Accum. Depr.
Company Investment is Gross Amount

Company Investment is Net of Accum. Depr.
Company Investment is Gross Amount

Company Investment is Net of Accum. Depr.
Company Investment is Gross Amount

Company Overall Revenue -

VDT Revenues Reach a Trigger % of Total Co. Rev.
(Set VDT/Co. Revenue Ratio at __ percent)

			Percentage	
[U S West]	[1]	a.	1	\$16.865
		b.	2	\$33.730

CERTIFICATE OF SERVICE

I, LeShawn M. Riley, a secretary of the law firm of Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C., hereby certify that on this 20th day of November, 1995, I caused a copy of the foregoing "Reply Comments of The California Cable Television Association in the Third Further Notice of Proposed Rulemaking" to be served on the persons specified below by first-class mail, postage prepaid, or by hand delivery*:

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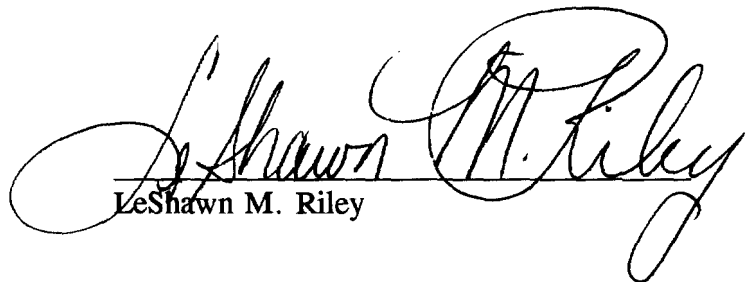
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